UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Connecticut General Life Insurance Company,
Appellant,
v.
Commissioner of Internal Revenue
(Tax Court No. 92-21212).

CIGNA Corporation And Consolidated
Subsidiaries, Appellants,
v.
Commissioner of Internal Revenue
(Tax Court No. 92-21213).

Nos. 97-7612, 97-7619.

Decided April 30, 1999.

OPINION OF THE COURT

SLOVITER, Circuit Judge.

Connecticut General Life Insurance Company, appellant in No. 97-7612, and CIGNA Corporation and Consolidated Subsidiaries ("the CIGNA Group"), appellants in No. 97-7619, appeal from the judgment of the United States Tax Court upholding notices of deficiency issued against them by the Commissioner of Internal Revenue in the amount of $62,176,665. For convenience, we will refer to the appellants collectively as "CIGNA." CIGNA complains that the Tax Court improperly deferred to the Commissioner's restrictive interpretation of the section of the Internal Revenue Code that limits the ability of affiliated insurance companies to file consolidated federal income tax returns. Because we conclude that the applicable Treasury regulation, as interpreted by the

Commissioner, is a permissible interpretation of the statute, we will affirm.

I. BACKGROUND

Traditionally, life insurance companies ("life companies") have been profitable, whereas companies writing property or casualty insurance (P & C) have often been unprofitable. Nonlife insurance companies ("nonlife companies") have long been permitted to file consolidated federal income tax returns with their affiliated nonlife companies, but not with their affiliated life insurance companies. Life companies were required to file separate returns or returns consolidated with other affiliated life companies.

The restrictions on life-nonlife consolidation were loosened when Congress enacted the Tax Reform Act of 1976. Pub. L. No. 94-455, 90 Stat. 1520. That Act modifies the Internal Revenue Code to permit life companies to file consolidated returns with nonlife companies, subject to certain exceptions (the "life-nonlife consolidation provisions"), for all taxable years beginning after December 31, 1980. *See* 26 U.S.C. §§ 1501, 1503-1504. At issue in this case is the interpretation of one of these statutory provisions, specifically the provision that limits certain setoffs between affiliated insurance companies filing consolidated returns.

A. The Statute

Section 1501 grants affiliated groups the privilege of making consolidated returns with their affiliated companies. If the affiliated group contains both life and nonlife members, § 1504 requires that a company belong to the group for at least five years before it is treated as affiliated therewith. Section 1503 then limits the extent to which losses incurred by nonlife members may be set off against gains realized by life members. Subsection (c)(1), in particular, caps the amount of nonlife setoff at a percentage of either nonlife loss or life income, whichever is less. It states:

> (1) In general — If . . . the consolidated taxable income of the [nonlife members] results in a consolidated net operating loss for such taxable year, then . . . the amount of such loss which cannot be absorbed in the applicable carryback periods against the taxable income of such [nonlife members] shall be taken into account in determining the consolidated taxable income of the affiliated group for such taxable year to the extent of 35 percent [30 percent in 1982] of such loss or 35 [30 percent in 1982] percent of the taxable income of the [life members], whichever is less.

26 U.S.C. § 1503(c)(1).

Subsection 1503(c)(2), the provision at issue here, further limits a group's ability to set nonlife losses off against life profits, providing: "Notwithstanding the provisions of paragraph [1503(c)(1)], a net operating loss for a taxable year of a [nonlife member of the group] *shall not be taken into account in determining the taxable income of a* [life member of the group] . . . if such taxable year precedes the sixth taxable year such members have been members of the same affiliated group . . . ." (emphasis added). Resolution of the instant dispute requires us to determine the scope of this latter limitation.

B. The Acquisitions

The facts of this case are not in dispute. *See* First Stipulation of Facts, App. at 71-88; Second Stipulation of Facts, App. at 89-104. On March 30, 1982, Connecticut General Corporation (Connecticut General), was the common parent of more than forty affiliated subsidiaries (the CG Group), one of which was a life company, Connecticut General Life Insurance Company (CGL). The CG Group met the definition of an affiliated group under § 1504 and had filed a consolidated tax return following the Code revision. Thereby, the CG Group was able to offset some of CGL's income with a portion of the CG Group's nonlife loss. App. at 75-76.

At that time, INA Corporation (INA) was parent to over 160 affiliated nonlife subsidiaries (the INA Group), which subsidiaries met the requirements of § 1504 and filed consolidated returns under § 1501. The INA Group's strength was in property and casualty insurance, while the CG Group's strength was in the areas of life, health and annuity, and personal and commercial property insurance. App. at 75-78.

The following day, March 31, 1982, Connecticut General and INA (the two parent companies) merged to form a new company, CIGNA Corporation (CIGNA Corp.). The merger was a "reverse acquisition" within the meaning of 26 C.F.R. § 1.1502-75(d)(3), pursuant to which CIGNA Corp. succeeded Connecticut General as the common parent of the CG Group, which continued to exist for tax purposes. CIGNA Corp. also became the common parent of each of the former members of the INA Group, which group ceased to exist for tax purposes. App. at 73-74. Thus, in effect, the CG Group, which became the CIGNA Group, acquired the former INA subsidiaries individually.

Subsequently, on November 20, 1984, a subsidiary of CIGNA Corp. acquired Preferred Health Care, Inc. (PHC). Like INA and Connecticut General before the merger, PHC was itself common parent to a group of affiliated corporations (the PHC Group) (all nonlife companies), which qualified under § 1504 and filed consolidated returns under § 1501. All members of the PHC Group became members of the CIGNA Group upon acquisition and the PHC Group itself ceased to exist. App. at 75, 79-80.

C. The Promulgation of Regulations

On June 8, 1982, approximately two months after the Connecticut General/INA merger, the Commissioner, pursuant to 26 U.S.C. § 1502, promulgated proposed rules relating to the filing of life-nonlife consolidated returns. *See* Filing of Life-Nonlife Consolidated Returns, 47 Fed. Reg. 24,737

(1982). The proposed regulations adopted a subgroup method for computing a life-nonlife group's consolidated taxable income. In effect, they treated the members of the group as two separate subgroups, with the life members as one subgroup and the nonlife members as another. Each subgroup was required to set off the gains and losses of members within that subgroup to determine whether the subgroup incurred a consolidated net operating loss (CNOL) or a gain. Only after the gains from within the nonlife subgroup were set off by losses from within that subgroup could such losses be used to reduce the life subgroup's income.

The regulations further limited the portion of a nonlife subgroup's consolidated net operating loss (nonlife CNOL) that could be set off (up to the statutorily prescribed percentage) against net operating gains generated by the life subgroup: "The offsetable nonlife consolidated net operating loss that arises in any consolidated return year . . . is the [nonlife CNOL] *reduced by the amount of the separate net operating loss . . . of any nonlife member that is ineligible in that year*." *Id.* at 24,748 (to be codified at 26 C.F.R. § 1.1502-47(m)(3)(vi)(A)) (emphasis added). The proposed rules thus distinguished between "eligible" companies — those that had been members of the group for at least five years — and "ineligible" companies — those that had not been members for at least five years.

CIGNA wrote to the Commissioner on February 28, 1983, suggesting that proposed regulation § 1.1502-47(m)(3)(vi)(A) not be adopted with respect to acquired groups. CIGNA suggested instead that "separate nonlife members be treated as one entity if they are acquired in a single transaction by one group but were members of a different group prior to their acquisition." Letter from Kenneth W. Gideon, Chief Counsel, IRS, to Judith Soltz, Senior Counsel, CIGNA Corp. 1 (March 22, 1983), App. at 197. Under CIGNA's suggested approach, the losses of one ineligible acquired member would be used to

offset the income of other ineligible acquired members, before the losses of eligible members were used for that purpose. The effect would be to increase the amount of eligible nonlife loss remaining after all nonlife gains had been offset, and thus to increase the nonlife offset the group could claim against life income.

Final regulations had to be issued by March 14, 1983 to be effective for the 1982 taxable year. App. at 197; *see also* 26 U.S.C. § 1503(a). The Commissioner did not adopt CIGNA's suggestion before issuing these regulations, but after the final regulations were issued, Kenneth W. Gideon, Chief Counsel to the IRS, sent CIGNA a letter, stating: "[The] final life-nonlife consolidated return regulations . . . do not adopt your suggestion but the preamble to the final regulation indicates that it will be given further study." App. at 197. Gideon also noted that "a lack of time [had] prevented a complete and thoughtful analysis of [CIGNA's] proposed solution." App. at 197- 98.

The final regulations and preamble did differ from the proposed regulations in three respects: (1) a new § 1.1502-47(m)(4) was added, which states in its entirety, "Acquired groups. [Reserved]"; (2) § 1.1502-47(m)(3)(vi)(A) was amended to note that its definition of ineligible NOL applies only "for purposes of . . . subparagraph (3)"; and (3) the preamble was amended to state:

> [T]he Treasury Department will study further whether it is appropriate to aggregate the income and losses of ineligible members in certain cases. For instance, notwithstanding the ordinary reading of section 1503(c)(2), it may be consistent with the intent of section 1503(c)(2), or correct as a matter of policy, to aggregate the income and losses of ineligible members that filed a consolidated return prior to their acquisition by (and includibility in) another group that files a consolidated return.

Filing of Life-Nonlife Consolidated Returns, 48 Fed. Reg. 11,436, 11,447-48, 11,440 (1983).

D. CIGNA's Consolidated Returns

In 1981, as soon as the Tax Reform Act of 1976 became effective, Connecticut General elected to take advantage of the opportunity the Act presented and treated CGL, its sole life insurance company affiliate, as an includible member of the CG Group, thereby setting off a portion of the CG Group's nonlife losses against CGL's income. For the years ending December 31, 1982 (which was after the INA acquisition) through December 31, 1985, CIGNA continued to file life-nonlife consolidated income tax returns. CGL, the only life company involved, had income throughout this period. The nonlife companies, which included, *inter alia*, those companies that were former members of the INA Group (for the 1982-85 returns) and the former members of the PHC Group (for the 1984-85 returns), had both income and loss. App. at 76, 80-81.

CIGNA computed its taxable income as follows:

1. It consolidated (netted out) the income and losses of all nonlife companies to arrive at the consolidated net operating loss or income.

2. It consolidated (netted out) the losses (all ineligible) and income of the former INA group members to calculate the net operating loss attributable to those companies as a group.

3. It consolidated (netted out) the losses (all ineligible) and income of the former PHC group members to calculate the net operating loss attributable to those companies as a group.

4. It aggregated the operating losses of other non life companies acquired within less than five years of the return (and hence ineligible).

5. It added 2, 3, and 4 above to calculate the ineligible net operating loss.

6. It subtracted the ineligible net operating loss from 1 above to calculate the eligible net operating loss.

App. at 85-86.

This treatment of the individual member companies of a former group as if they were a single company has been called the single entity method. Under CIGNA's approach, the losses of the former group members were reduced by the income of the members of that group, and that reduced loss was the figure treated as ineligible and deducted from the consolidated net operating loss of all the members of the CIGNA Group.

As calculated by CIGNA, the acquisition of the INA Group had no effect on its tax liability, and the overall taxable income of the CIGNA Group (including the INA and PHC Groups) in the years 1982 through 1985 was equal to the sum of what would have been these three groups' separate taxable incomes had the groups not combined. *See* Appellants' Br. at 12, 20.

E. The Commissioner's Audit

On June 23, 1992, the Commissioner of Internal Revenue issued notices of deficiency to CGL for its taxable year ending December 31, 1980, and to CIGNA Group for its taxable years ending December 31, 1982 through December 31, 1985. App. at 28-31, 45-53.

Following the mode of analysis set forth in 26 C.F.R. § 1.1502-47(m)(3)(vi)(A), the Commissioner calculated CIGNA's ineligible loss in the following manner:

1. The income and losses of all nonlife companies were consolidated (netted out) to arrive at the consolidated net operating loss or income.

2. The losses of each of the companies acquired within less than five years of the return were aggregated to calculate the ineligible net operating loss.

3. The ineligible net operating loss was subtracted from the figure arrived at after the calculation in 1 above to calculate the eligible net operating loss.

App. at 87.

The Commissioner thus applied the separate entity method under which each of the former members of the INA and PHC Groups (all nonlife companies) was treated as a separate entity whose loss, if any, was subtracted from the consolidated net operating loss because the member was affiliated less than five years. Because each acquired company is treated as a separate entity, the fact that it was part of a group acquisition or that the group, prior to being acquired, had previously filed a consolidated return is not taken into account or relevant to its tax treatment after the acquisition.

The contrasting methods made a substantial difference in the amount of net operating loss of the nonlife companies that could be taken into account in determining CIGNA's taxable income for 1982 through 1988. The following shows the result of the Commissioner's approach and that used by CIGNA in filing its returns with respect to the nonlife net operating loss eligible to reduce CGL's taxable income.

Eligible Nonlife Net Operating Loss

Year	CIGNA Calculation	Commissioner Calculation
1982	($34,888,309)	($10,225,979)
1983	($28,810,677)	($8,351,216)
1984	($116,008,516)	($26,734,260)
1985	($ 96,060,581)	($94,424,416)

(These numbers are undisputed and reflect the appropriate 30% or 35% limitation set forth in § 1503(c)(1)).

Thus, under the Commissioner's approach, because of the reduction in the eligible nonlife net operating loss, the CIGNA Group had $136,032,212 more consolidated taxable income than under CIGNA's approach. App. at 42, 54. The Commissioner assessed the following deficiencies accordingly:

Petitioner	*Year*	*Deficiency*
CGL	1980	$ 3,360,873[1]
CIGNA Group	1982	$15,080,878
CIGNA Group	1983	$ 1,916,121
CIGNA Group	1984	$41,066,157
CIGNA Group	1985	$ 752,636

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[1] The deficiency determined against CGL flows indirectly from the Commissioner's disallowance of a portion of the nonlife loss setoffs the CIGNA Group claimed on its returns. Resolution of CIGNA's claim regarding these setoffs will determine what, if any, deficiency is properly assessed against CGL. App. at 72-73.

Total Tax Deficiency (exclusive of interest and penalties): $62,176,665[2]

On September 21, 1992, the CIGNA Group and CGL petitioned the Tax Court for a redetermination of the deficiencies set forth in the Commissioner's Notices of Deficiency. App. at 23-31, 38-53. The cases were subsequently consolidated. On February 23, 1996 and February 26, 1996, respectively, the Commissioner and CIGNA filed motions for summary judgment before the Tax Court. App. at 57-66. That court found in favor of the Commissioner. *Connecticut Gen. Life Ins. Co. v. Commissioner*, 109 T.C. 100 (1997). The CIGNA Group and CGL each filed a Notice of Appeal on November 21, 1997. App. at 2, 5.

The sole issue before the Tax Court was the proper calculation of the offsetable consolidated net operating loss of recently acquired nonlife companies (INA and PHC) when the group by which they were acquired (ultimately CIGNA) files a life-nonlife consolidated return under the auspices of § 1503(c)(1) and (2). The Tax Court found that "under [CIGNA's] single entity method losses of the ineligible nonlife companies of the former INA and PHC Groups were, in effect, indirectly made available to reduce income of [CGL], the life company." *Connecticut Gen. Life Ins. Co.*, 109 T.C. at 104. Because it also found the Commissioner's interpretation of the legislative regulations to be "sufficiently consistent with section 1503(c)(2) and its legislative purpose" to merit *Chevron* deference, *see Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984), the court upheld the notices of deficiency. Connecticut Gen. Life Ins. Co., 109 T.C. at 111-12. The Tax Court had jurisdiction under 26 U.S.C. §§ 6213(a), 6214(a) and 7442. We have jurisdiction to review

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[2] In CIGNA's appellate brief, it reported that interest on the deficiency was more than $150 million at that time. Appellants' Br. at 3.

that court's grant of summary judgment under 26 U.S.C. § 7482. Our review is plenary. *See Lerman v. Commissioner*, 939 F.2d 44, 46 (3d Cir. 1991).

II. DISCUSSION

CIGNA contends that it was error for the Tax Court to uphold the deficiency assessments because the method CIGNA used in calculating its tax liability complied with all applicable laws and regulations. CIGNA's primary argument is that because none of the regulations adopted by the Commissioner in 1983 explicitly covers a group acquisition, it was free to follow any reasonable method to calculate the net operating loss of the members of the acquired INA and PHC Groups. *See Gottesman & Co. v. Commissioner*, 77 T.C. 1149 (1981) (holding that, after Commissioner proposed two conflicting regulations but adopted neither, leaving no regulation in place, the taxpayer's choice of one of the proposals was reasonable and would be sustained). It disagrees with the Commissioner's position that 26 C.F.R. § 1.1502-47(m)(3)(vi)(A) applies to acquired groups of nonlife companies, and it argues that the regulation is limited to acquisition of stand alone companies. As an alternative, CIGNA argues that if Regulation -47(m)(3)(vi)(A) is interpreted to govern the group acquisitions at issue, then that regulation is arbitrary, capricious, and therefore unenforceable.

When Congress enacted the Internal Revenue Code revisions on consolidated returns, it gave the Secretary of the Treasury broad authority to promulgate necessary regulations with respect thereto. *See* 26 U.S.C. § 1502. Pursuant to this authority, the Secretary promulgated the regulations at issue here, which are deemed legislative in character. *See Tate & Lyle, Inc. v. Commissioner*, 87 F.3d 99, 104 (3d Cir. 1996).

Ordinarily, our review of an agency's construction of the statute it has been charged with executing is deferential. In

Sekula v. FDIC, 39 F.3d 448 (3d Cir. 1994), we summarized our standard of review as follows:

> When reviewing an agency's construction of a statute, if the intent of Congress is clear, then we must give effect to that intent. If the statute is silent or ambiguous with respect to a specific issue, then a deference standard applies, and the question for the court becomes whether the agency's answer is based on a reasonable construction of the statute. In determining whether an agency's regulation complies with its congressional mandate, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. So long as the regulation bears a fair relationship to the language of the statute, reflects the views of those who sought its enactment, and matches the purpose they articulated, it will merit deference.

Id. at 451-52 (citations omitted).

To merit deference, an agency's interpretation of the statute must be supported by "regulations, rulings, or administrative practice." *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212 (1988). We will not defer to "an agency counsel's interpretation of a statute where the agency itself has articulated no position on the question." *Id.*

Once an agency has adopted regulations interpreting the statute, the agency's consistent interpretation of its own regulation will also be accorded substantial deference. We "must defer to the [agency's] interpretation unless an 'alternative reading is compelled by the regulation's plain language or by other indications of the [agency's] intent at the time of the regulation's promulgation.'" *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994) (quoting *Gardebring v. Jenkins*, 485 U.S. 415, 430 (1988)); accord *Shell Oil Co. v. Babbitt*, 125 F.3d 172, 176 (3d Cir. 1997).

Nonetheless, "[t]he responsibility to promulgate clear and unambiguous standards is upon the Secretary." *Director, Office*

of Workers' Compensation Programs, U.S. Dept. of Labor v. Eastern Associated Coal Corp., 54 F.3d 141, 147 (3d Cir. 1995) (internal quotation marks omitted). Thus our deference to an agency's interpretation of its own regulations is "tempered by our duty to independently insure that the agency's interpretation comports with the language it has adopted." *Director, Office of Workers' Compensation Programs, U.S. Dept. Of Labor v. Gardner*, 882 F.2d 67, 70 (3d Cir. 1989).

A. Whether an Applicable Regulation Has Been Adopted

In order for CIGNA to prevail on its primary argument, it must convince us that no regulation governs the manner in which consolidated net operating loss of acquired groups must be treated. At the outset, CIGNA faces a major hurdle because the Commissioner concededly did promulgate a regulation, -47(m)(3), which deals with the treatment of acquired nonlife members. CIGNA concedes that Regulation -47(m)(3) governs the treatment of acquired stand-alone nonlife members, but it argues that it does not cover the treatment of "*acquired groups*" of nonlife members. As to those, CIGNA asserts, there was no regulation promulgated by the Commissioner, who instead reserved that question for another day under Regulation -47(m)(4).

The Internal Revenue Service (IRS) interprets these regulations differently. It insists that Regulation -47(m)(3) applies to all ineligible nonlife companies, whether they are acquired individually or as part of a group. It interprets Regulation -47(m)(4) as doing no more than reserving a place in the *Code of Federal Regulations* for the Commissioner to insert a regulation requiring different treatment of acquired groups should the Commissioner later determine that such different treatment is appropriate.

CIGNA argues that, under *Bowen*, 488 U.S. at 212, the interpretation the Commissioner advances in this case is not

entitled to deference because it is a "mere" litigating position. CIGNA's reliance on *Bowen* is misplaced. *Bowen*, which concerned the amount of deference due an administrative agency's informal interpretation of a statute, does not address what deference we should accord an agency's interpretation of its own regulations, such as is at issue here. Indeed, the Supreme Court has deferred to an agency's interpretation of its own regulations, even when that interpretation was proffered for the first time in litigation, *see Gardebring v. Jenkins*, 485 U.S. 415, 430 (1988), as have we, *see Elizabeth Blackwell Health Ctr. for Women v. Knoll*, 61 F.3d 170, 183 & n. 9 (3d Cir. 1995).

Thus, we will defer to the IRS's interpretation unless that "alternative reading is compelled by the regulation's plain language or by other indications of the [agency's] intent at the time of the regulation's promulgation." *Gardebring*, 485 U.S. at 430.

1. The Text of -47(m)(4)

CIGNA insists that unless subsection 26 C.F.R. § 1.1502-47(m)(3)(vi) applies only to the acquisition of individual companies, the heading "Acquired groups" on -47(m)(4) would be without significance. CIGNA emphasizes the designation of "[Reserved]" on that regulation and points to various definitions which equate the terms "reserved" and "reserve" with notions of setting aside or apart and of deferring a determination. CIGNA then further claims that this interpretation of "reserved" accords with both the Commissioner's past administrative practice and the understanding of former high-ranking treasury officials.

We are not convinced. We agree that use of the term "reserved" implies that something has been set aside. CIGNA, however, assumes that what was set aside was "the subject matter of the regulation" and further that the subject matter of the regulation was "the treatment of the loss of nonlife

members acquired as a group." Appellant's Br. at 24. It is equally likely that what was set aside was the numerical subsection -47(m)(4) and the space in the regulation it demarcates.

CIGNA further attempts to establish that the "Commissioner's customary administrative practice [was to] interpret[ ] 'reserved' in a regulation as a signal that there is no regulatory rule to govern the referenced subject matter" by identifying some instances in which the Commissioner used that term to have that meaning. Appellant's Br. at 24. That is not conclusive. In fact, the Office of the Federal Register, *Document Drafting Handbook* (1991), suggests a different use for the term "reserved." It describes "reserved" as "a term used to maintain the continuity of codification in the CFR" or "to indicate where future text will be added." *Id.* at 27. We find nothing in the precedent that CIGNA cites to preclude the Commissioner from using the term "reserved" in accordance with the *Document Drafting Handbook*, rather than to connote the absence of a substantive rule.

Finally, we accord little weight to the 1996 recollections of the several Treasury officials who submitted affidavits regarding the meaning of the reserved clause for acquired groups. In the first place, the affidavits are inconsistent: William McKee states that "reserved" means that no regulation addresses the treatment of the reserved issue, App. at 226, but Andrew D. Pike understood that the general rule would continue to apply until a special rule was created for acquired groups, App. at 229. Moreover, reliance upon remembered details from officials who lacked the ultimate authority to issue any proposed regulation has little support in the law. *See Armco, Inc. v. Commissioner*, 87 T.C. 865, 867 (1986) ("[N]o one's personal views can be accepted as a pronouncement of the intended meaning of the regulation."); *cf. Western Air Lines, Inc. v. Board of Equalization*, 480 U.S. 123, 131 n. * (1987) ("[The] attempt at the creation of legislative history

through the *post hoc* statements of interested onlookers is entitled to no weight. . . .").

In sum, we, like the Tax Court, conclude that nothing in Regulation -47(m)(4) contradicts the Commissioner's interpretation of Regulation -47(m)(3)(vi) as applying to acquired groups. At most, Regulation -47(m)(4) is a "neutral factor." *Connecticut Gen. Life Ins. Co.*, 109 T.C. at 109.

2. The Preamble

CIGNA next contends that the preamble supports its view that there is no rule governing the acquisition of groups. We have stated that "the preamble to a regulation may be used as an aid in determining the meaning of a regulation." *Commonwealth of Pennsylvania v. United States Dept. of HHS*, 101 F.3d 939, 944 n.4 (3d Cir. 1996). Here, the Preamble states, "[T]he Treasury Department will study further whether it is appropriate to aggregate the income and losses of ineligible members in certain cases. For instance, notwithstanding the ordinary reading of § 1503(c)(2), it may be consistent with the intent of § 1503(c)(2), or correct as a matter of policy, to aggregate the income and losses of ineligible members that filed a consolidated return prior to their acquisition by (and includibility in) another group that files a consolidated return." Filing of Life-Nonlife Consolidated Returns, 48 Fed. Reg. at 11,440.

This passage does not contradict the IRS's interpretation of Regulation -47(m)(3)(vi) as applying to acquired groups. Indeed, it suggests that applying a rule other than that annunciated in -47(m)(3)(vi) would contradict "the ordinary reading of section 1503(c)(2)." The passage does suggest that it might be justifiable, nonetheless, to have such a rule, and it indicates that officials within the Treasury would consider adopting a different rule for acquired groups. Significantly, no such special rule was ever adopted. Under these circumstances, there is nothing unreasonable about the

Commissioner's enforcement of the rule that did exist, a rule that, by its own terms, applies to these facts.

Because the interpretation advanced by the IRS is neither inconsistent with any prior interpretation of these regulations nor incompatible with their plain text, we defer to that interpretation. We thus regard -47(m)(3) as applicable to acquired groups.

B. Whether the Regulation is Arbitrary, Capricious, and Unreasonable

CIGNA's alternative argument is that the regulation, which is interpreted by the Commissioner to be applicable to treatment of acquired groups, is not entitled to deference because it is arbitrary, capricious, and unreasonable. CIGNA concedes that we must defer to a regulation that is a reasonable implementation of the congressional mandate, but it argues that a regulation is only a reasonable statutory interpretation if it "'harmonizes with the statute's plain language, origin, and purpose.'" Appellants' Br. at 31-32 (citing *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979)). Thus, we must review the legislative history of the Tax Reform Act of 1976 with an eye toward discerning the origin and purpose of the revision allowing life-nonlife consolidated tax returns.

In the debates before Congress, it was suggested that lifting the ban on life-nonlife consolidated returns would help alleviate the acute shortage of insurance writing capacity in the property and casualty industry. *See, e.g.*, 122 Cong. Rec. 24,683 (statement of Sen. Ribicoff), 24,687 (statement of Sen. Curtis); S. Rep. No. 94-938, at 456, *reprinted in* 1976 U.S.C.C.A.N. 3439, 3882. The Senate Report noted that P & C companies affiliated with other nonlife companies had long been permitted to file consolidated returns whereas P & C companies that happened to be affiliated with life companies had not been able to do so. *See* S. Rep. No. 94-938, at 454, *reprinted in* 1976

U.S.C.C.A.N. at 3881. The Report states: "[T]he present ban on life-nonlife consolidations has been a hardship for casualty companies which are affiliated with life companies," and explains that "[t]he committee amendment deals with this problem." *Id.*

At the same time, the legislators recognized that the then-existing ban on consolidated returns had assured that life insurance companies paid tax at the regular rate on an amount approximately equal to their taxable investment income. They sought to retain that result in drafting the new life-nonlife provisions, presumably by limiting the permissible offset to a percentage of life income incorporated in § 1503(c)(1). *See id.*; Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976 (H.R. 10612, 94th Congress, Public Law 94-455)* at 435-36 (1976) ("[C]ongress adopted a provision which preserves the concept that some tax be paid with respect to the life insurance company's investment income . . . but which at the same time provides substantial relief in the future for casualty companies with losses.").[3]

Shortly before the bill was enacted, the Conference Committee added § 1503(c)(2), the section at the center of the CIGNA-IRS dispute. That section provides that the net operating loss of a member of the group of affiliated companies "shall not be taken into account" unless that member has been a member of that group for five years. The Conference Report does not suggest a reason for this amendment. The slim legislative history reveals merely that, during the hearings relating to the life-nonlife consolidation provisions, Senator Kennedy in particular had expressed some concern that the

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[3] The Senate Report estimated that these provisions would "result in a decrease in revenues of $25 million in the fiscal year 1978, $55 million in the fiscal year 1979, $49 million in the fiscal year 1980, and $40 million in the fiscal year 1981." S. Rep. No. 94-938, at 457, *reprinted in* 1976 U.S.C.C.A.N. at 3884.

largest life insurance companies might seek to enlarge the tax benefit provided by the new provisions by acquiring small loss-ridden P & C companies for the purposes of generating nonlife losses and setting these losses off against their taxable income. *See id.* at 24,685 ("Those [life insurance companies] who have substantial profits can go out and purchase other companies with tax losses in order to be able to write these losses off."). Section 1503(c)(2), as enacted, thus appears to have been designed to discourage tax-motivated acquisitions by insurance companies.

CIGNA argues that the Commissioner's approach runs counter to the origins and purposes of the Tax Reform Act of 1976 "because it exacerbates the very problem that Congress sought to address by enacting the life-nonlife consolidation provisions." Appellants' Br. at 31. CIGNA notes that although, collectively, the former INA Group members suffered net losses in each of the four years following their acquisition, under the Commissioner's calculation the combined group's taxable income increased by $136 million and its tax liability increased by approximately $60 million over the same four-year period, thereby reducing the group's capacity to write insurance. CIGNA characterizes the Commissioner's interpretation of Regulation -47(m)(3)(vi) as thus "penaliz[ing] the P & C industry contrary to the purpose of the life-nonlife consolidation provisions." Appellants' Br. at 33.

CIGNA's assessment of the congressional purpose is overly narrow. Congress did have an interest in increasing the capacity of the industry to write P & C insurance, which it effected through § 1501, which enables P & C companies to offset (partially) their losses against the income of their life affiliates by filing consolidated returns. Nothing in the regulations promulgated by the Commissioner prevented the former CG Group from taking full advantage of this opportunity by filing a consolidated tax return for its affiliated

companies and offsetting the P & C losses against life income, which it did beginning in 1981.

But, Congress apparently also had another subsidiary goal — to limit tax-induced shopping for acquisitions. And when the former CG Group chose, within a year of the statute's effective date, to affiliate with the INA Group to form CIGNA, it ran into § 1503, the section Congress enacted to effectuate that subsidiary goal. Although CIGNA could continue to have the advantage of offsetting P & C losses within its historic group after the acquisition, it could not take advantage in any way of the losses of the INA Group. And CIGNA's protests notwithstanding, that is precisely what it seeks to do.

If none of the INA companies had income, § 1503 would be irrelevant, as the methods proffered by both CIGNA and the Commissioner would arrive at the same result; the same is true if all of the INA companies had income, as their income would be added to the income of the other affiliated companies. However, CIGNA proposes to permit the INA companies to offset income within the group by losses within the group before that income is added to that of the other now affiliated companies. In terms that may be too simplistic for the hundreds of millions of dollars at issue, this reduces the amount of income that could be added to the total CIGNA income. As the Commissioner explains, the net operating loss of a company that has not been a member of the group for five years is thus being "taken into account" by reducing the total income.

Perhaps recognizing that § 1503 serves a goal other than that of increasing P & C capacity, CIGNA describes the purpose of that section narrowly: "Section 1503(c)(2) had a narrow[ ], targeted purpose, and was intended only to address the specific concern that life companies might have a tax incentive to acquire nonlife companies to take advantage of additional future loss offset benefits." Appellants' Br. at 36. CIGNA insists that § 1503(c)(2) "was intended only to limit the *incremental* consolidation benefit that might be derived from

the acquisition of additional nonlife companies." *Id.* It then argues that the Commissioner's approach contradicts the statute by denying CIGNA more than this incremental benefit.

CIGNA points to nothing in the scant legislative history of this provision that compels such a narrow reading of § 1503(c)(2)'s purpose. Moreover, the statute contains no language that limits its effect to the denial of the incremental consolidation benefit. It says nothing more than that losses of companies that affiliated with the group less than five years ago shall not be taken into account.

CIGNA's argument that the Commissioner has interpreted § 1503(c)(2) too broadly focuses too narrowly on the short-term. Section 1503 only limits offsets for five years following an acquisition. After that time, group insurance companies such as CIGNA can offset the losses of acquired companies as permitted, thereby effecting an increase in P & C capacity. There is no indication that Congress focused, in the final stages of enactment of the Tax Reform Act of 1976, on the situation of group companies acquiring group companies. Even if it had, there is even less reason to think that it would have been swayed by the potential short-term disadvantage to some companies. More likely is that Congress was interested in the long-run solution. After all, it was Congress that imposed the five-year limitation in the first place.

Finally, CIGNA makes a policy argument that the INA companies should be permitted to offset losses against income because they had been permitted to do so before the acquisition. It contends that the Commissioner's regulation, as interpreted, is unfair because it requires that the income of profitable members of the acquired group be taken into account, but not the loss of acquired members. The simple answer, obviously unsatisfactory to CIGNA, is that the Commissioner, who has the delegated authority to promulgate legislative regulations, did not provide for initial offsets within the group. And there is no language in the statute that requires

the offset CIGNA seeks. In fact, there was disagreement within the IRS as to whether the Commissioner could have provided for such initial offsets without contradicting the statute. Before us, the IRS continues to characterize that question as arguable. Inasmuch as the Commissioner did not adopt CIGNA's approach, the issue is not before us and we make no comment.

We do note, however, that if CIGNA's approach were adopted, it would create a distinction between nonlife companies acquired as a group and those very same companies acquired individually that is hard to justify. Had CIGNA acquired only INA's profitable nonlife companies in 1981, there is no question that the acquisition would have increased its overall taxable income. And, as CIGNA presumably concedes, had CIGNA subsequently acquired the remainder of the INA Group, § 1503(c)(2) would have precluded offsetting that increase in taxable income with the losses of the later-acquired members. CIGNA has offered no justification for requiring the Commissioner to treat the instant case differently, merely because both acquisitions occurred on the same day.

The overriding determinant is that the Commissioner's regulation is authorized by the statute, and his interpretation of that regulation is not so unreasonable as to be declared invalid by this court on policy grounds. That is not our function or our decision. As the Supreme Court has emphasized, "[w]hen Congress . . . has delegated policymaking authority to an administrative agency, the extent of judicial review of the agency's policy determinations is limited." *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 696 (1991).

III. CONCLUSION

For the reasons set forth, we agree with the Tax Court, and will affirm its judgment.

UNITED STATES TAX COURT

Connecticut General Life Insurance Company, Petitioner,
v.
Commissioner of Internal Revenue, Respondent.

CIGNA Corporation and Consolidated Subsidiaries, Petitioner,
v.
Commissioner of Internal Revenue, Respondent.

No. 21212-92, 21213-92.
Aug. 12, 1997.

OPINION

SWIFT, Judge:

These consolidated cases are before the Court under Rule 121 on the parties' cross-motions for summary judgment. Petitioners contend that if their motion for summary judgment is not granted, a certain factual matter remains in dispute that precludes summary judgment in favor of respondent.

The issue for decision is whether, in consolidating nonlife insurance companies (sometimes referred to as nonlife companies) with life insurance companies (sometimes referred to as life companies) and for purposes of calculating, under section 1503(c)(1) and (2), the amount of net operating losses of nonlife companies that may reduce income of life companies, companies that constituted members of a "recently acquired" affiliated group of nonlife companies that previously filed consolidated Federal income tax returns are to be treated as a single aggregate entity, as petitioners contend, or as separate entities, as respondent contends.

The issue presented in these cross-motions for summary judgment involves deficiencies determined by respondent in the Federal income taxes of petitioners Connecticut General Life Insurance Co. (ConnLife) and CIGNA Corp. and their consolidated subsidiaries (CIGNA) as follows:

Petitioner	*Year*	*Deficiency*
ConnLife	1980	$ 3,360,873
CIGNA	1982	15,080,878
CIGNA	1983	1,916,121
CIGNA	1984	41,066,157
CIGNA	1985	752,636
Total		$62,176,665

Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

For 1981 and through March 31, 1982, Connecticut General Corp. (CG), ConnLife, and CG's over 40 affiliates (the CG group) joined in filing consolidated Federal income tax returns, with CG as the common parent of the affiliated group. ConnLife constituted the sole life insurance company in the CG group. Members of the CG group were engaged primarily in selling, underwriting, and servicing various types of insurance (namely, individual and group life, health and annuity insurance, and personal and commercial property and casualty (P & C) insurance).

Acquisition of INA

On March 31, 1982, the CG group and INA Corp. (INA) and its over 160 affiliated companies (the INA group) combined for substantial business reasons by way of a tax-free

reorganization under section 368. As the culmination of the reorganization, CIGNA was incorporated on March 31, 1982, as the holding company for the surviving affiliated business entities.

In years prior to the combination of the CG and the INA groups, INA and its affiliates had filed consolidated Federal income tax returns, with INA as the common parent corporation of the affiliated INA group. Members of the INA group were engaged primarily in selling, underwriting, and servicing P & C insurance.

The reorganization involving the CG and the INA groups was treated as a reverse acquisition under section 1.1502-75(d)(3), Income Tax Regs. After the reorganization and for Federal income tax purposes, the CG group was treated as continuing in existence and the INA group was treated as ceasing to exist. CIGNA was treated as the common parent corporation of the continuing CG group (the CIGNA group), and companies that constituted members of the former INA group became members of the CIGNA group.

Acquisition of PHC

On November 20, 1984, an affiliate of CIGNA acquired 89.9 percent of the stock of Preferred Health Care, Inc. (PHC), in a taxable transaction. As a result of this transaction, PHC and its subsidiary companies (the PHC group) terminated, and companies that constituted members of the former PHC group became members of the CIGNA group.

In years prior to the acquisition by CIGNA of PHC and its subsidiary companies, PHC and its subsidiaries had filed consolidated Federal income tax returns, with PHC as the common parent corporation of the affiliated PHC group. The PHC group operated prepaid dental programs in Florida, New Jersey, and eastern Pennsylvania.

Consolidated Federal Income Tax Returns of the CIGNA Group

For 1982 through 1985, the consolidated Federal income tax returns that were filed on behalf of the CIGNA group included the companies that constituted members of the former INA group.

For 1984 and 1985, the consolidated Federal income tax returns that were filed on behalf of the CIGNA group also included the companies that constituted members of the former PHC group.

For 1982 through 1985, under a special rule set forth in section 1504(c) allowing life insurance companies to file consolidated Federal income tax returns with nonlife affiliated companies, ConnLife was included as the sole life insurance company in the above consolidated Federal income tax returns of the CIGNA group.

For 1982 through 1985, all of the nonlife companies that constituted members of the CIGNA group incurred the following consolidated net operating losses (CNOL's), and ConnLife, the only life insurance company in the CIGNA group, earned the following income:

Year	*CNOL's of nonlife companies*	*Income of ConnLife*
1982	($197,385,675)	$116,294,363
1983	(244,963,449)	82,316,221
1984	(553,077,555)	331,452,903
1985	(1,229,220,860)	274,458,803

The above CNOL's of the nonlife companies consisted of CNOL's of both eligible companies under section 1503(c)(2) (namely, nonlife companies that had been members of the prior

CG group and the CIGNA group for at least 5 years) and ineligible companies under section 1503(c)(2) (namely, nonlife companies that had not been members of the prior CG group and the CIGNA group for at least 5 years). Because they had not been members of the prior CG group and the CIGNA group for at least 5 years, all of the companies that constituted members of the former INA and PHC groups constituted ineligible nonlife companies.

On the consolidated Federal income tax returns for 1982 through 1985 — in order to calculate the amount of net operating losses (NOL's) attributable to the nonlife companies that had previously constituted members of the former INA and PHC groups and that therefore constituted losses of ineligible companies that could not be used to reduce income of ConnLife (the sole life company in the consolidated CIGNA group) — the CIGNA group treated all of the companies that constituted members of the former INA and PHC groups as two single, aggregate, respective entities, and the net aggregate respective losses of the companies that constituted members of the former INA group and the former PHC group were netted against the respective taxable income of the other companies that constituted members of the former INA group and the former PHC group (single entity method). In other words, for purposes of calculating the portion of the net operating losses of the nonlife companies that constituted members of the former INA group that, on the CIGNA group's consolidated Federal income tax returns for 1982 through 1985, were not allowed to reduce income of ConnLife, all companies that constituted members of the former INA group were treated as a single aggregate entity, and losses of the ineligible companies that constituted members of the former INA group were reduced by income earned by other companies that constituted members of the former INA group.

Further, for purposes of calculating the portion of the net operating losses of the nonlife companies that constituted

members of the former PHC group that, on the CIGNA group's consolidated Federal income tax returns for 1984 and 1985, were not allowed to reduce the income of ConnLife, all of the companies that constituted members of the former PHC group were treated as a single aggregate entity, and losses of the companies that constituted members of the former PHC group were reduced by income earned by other companies that constituted members of the former PHC group.

On audit, for 1982 through 1985, in order to calculate the amount of net operating losses attributable to the nonlife companies that had previously constituted members of the former INA and PHC groups and that therefore constituted losses of "ineligible" companies that could not be used to reduce income of ConnLife, respondent determined that each of the companies that constituted members of the former INA and PHC groups should be treated as a separate entity (separate entity method), rather than merely as a part of the respective former INA and PHC groups.

The difference between petitioners' single entity method and respondent's separate entity method is that under petitioners' single entity method losses of the ineligible nonlife companies of the former INA and PHC groups were, in effect, indirectly made available to reduce income of ConnLife, the life company. Under respondent's separate entity method losses of ineligible nonlife companies of the former INA and PHC groups are not, to any extent, made available to reduce income of ConnLife.

The following schedule reflects for each of the years 1982 through 1985 petitioners' and respondent's respective calculations of the amount of nonlife CNOL's that they claim should be available under section 1503(c)(1) and (2) and the regulations thereunder to reduce ConnLife's income:

*Nonlife CNOL's eligible to reduce income of ConnLife**

Year	*Petitioners' single entity method*	*Respondent's separate entity method*
1982	($34,888,309)	($10,225,979)
1983	(28,810,677)	(8,351,216)
1984	(116,008,516)	(26,734,260)
1985	(96,060,581)	(94,424,416)

* These figures reflect CNOL's after application of certain percentage limitations contained in sec. 1503.

Discussion

Summary judgment may be granted if the pleadings and other materials demonstrate that no genuine issue exists as to any of the material facts and that a decision may be rendered as a matter of law. Rule 121(b); *Colestock v. Commissioner*, 102 T.C. 380, 381 (1994); *Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520 (1992), *aff'd*, 17 F.3d 965 (7th Cir.1994).

Under section 1504(c)(2) and subject to certain limitations not here relevant, an affiliated group of companies that includes nonlife and life companies may elect to file consolidated Federal income tax returns and to include the life companies in the consolidated income tax returns. Sec. 1504(c)(2).

The above election to consolidate on a limited basis nonlife and life companies was added to the Code as part of the Tax Reform Act of 1976, Pub. L. 94-455, sec. 1507(a), 90 Stat. 1739, in order that nonlife companies (such as P & C insurance companies, which P & C industry had been experiencing losses and a diminished capacity to write insurance) could use nonlife

losses to reduce income of affiliated life companies. Congress anticipated that the option to consolidate nonlife and life companies would, in particular, improve the financial condition of P & C insurance companies. *See* S. Rept. 94-938, at 454-455 (1976), 1976-3 C.B. (Vol. 3) 49, 492-493.

Congress, however, in order to minimize trafficking by profitable life insurance companies in unprofitable P & C insurance companies, provided certain rules and limitations on the use in consolidated Federal income tax returns of nonlife losses to reduce life income. *See* S. Rept. 94-938, *supra* at 454-455, 1976-3 C.B. (Vol. 3) at 492-493; 122 Cong. Rec. 24680-24685 (1976).

Section 1503(c)(1) provides generally that where an election is made under section 1504(c)(2) to include both nonlife and life companies in a consolidated Federal income tax return, certain losses of nonlife companies may be taken into account and may reduce income of the life companies included in the return but only pursuant to regulations prescribed by the Secretary. Sec. 1503(c)(1).

Section 1503(c)(1) also provides that nonlife losses must first be carried back against prior year income of the particular nonlife companies that incurred the losses, and nonlife losses that are not absorbed as carrybacks against prior year income of the nonlife companies may be applied against income of the life companies to the extent of only 35 percent of the nonlife CNOL or 35 percent of the income of the life companies, whichever is less.[1] Section 1503(c)(1) provides in part as follows:

> (1) In general — If an election under section 1504(c)(2) is in effect for the taxable year and the consolidated taxable

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[1] For 1982, sec. 1503(c)(1) limits the losses that are allowed to reduce life income to 30 percent of the income of the life companies or 30 percent of the nonlife CNOL, whichever is less.

> income of the * * * [nonlife members of the group] results in a consolidated net operating loss for such taxable year, then under regulations prescribed by the Secretary, the amount of such loss which cannot be absorbed in the applicable carryback periods against the taxable income of such * * * [nonlife members of the group] shall be taken into account in determining the consolidated taxable income of the affiliated group for such taxable year to the extent of 35 percent of such loss or 35 percent of the taxable income of the * * * [life members of the group], whichever is less. * * *

Section 1503(c)(2) provides a further specific limitation on the use of nonlife losses to reduce life income where the particular nonlife losses that are involved are realized by companies that were not, for the immediately preceding 5 years, part of the same affiliated group that is now filing a consolidated Federal income tax return. Section 1503(c)(2) provides in pertinent part as follows:

> a net operating loss for a taxable year of a * * * [nonlife member of the group] shall not be taken into account in determining the taxable income of a * * * [life member of the group] if such taxable year precedes the sixth taxable year such members have been members of the same affiliated group * * *.

Under legislative regulations promulgated under sections 1502 and 1503, for purposes of calculating the amount of nonlife losses that is allowed to reduce life income pursuant to section 1503(c)(2), each nonlife company that constitutes a member of the consolidated group is treated as a separate entity, and the CNOL of all of the nonlife companies included in the consolidated Federal income tax return (after allowable carrybacks) is reduced by the separate "ineligible NOL" of each ineligible nonlife company that constitutes a member of the consolidated group. Sec. 1.1502-47(m)(3)(vi), Income Tax

Regs. Section 1.1502-47(m)(3)(vi)(A), Income Tax Regs., provides, in pertinent part, as follows:

> the "ineligible NOL" is in the year the loss arose the amount of the separate net operating loss * * * of any nonlife member that is ineligible in that year * * *.

No provision is made in the above legislative regulations to treat a company that prior to acquisition had been a member of a group that had filed a consolidated income tax return as part of a single, aggregate group of companies and to net within that group losses of ineligible nonlife companies against income of other nonlife companies of the same acquired group.

Petitioners note, however, that the legislative regulations under sections 1502 and 1503 provide a "reserved" subparagraph for "acquired groups". Sec. 1.1502-47(m)(4), Income Tax Regs. That reserved subparagraph states merely as follows: "*Acquired Groups*. [Reserved.]".

Petitioners note further that in the preamble accompanying section 1.1502-47, Income Tax Regs., a comment is made to the effect that applying petitioners' single entity method to ineligible nonlife companies that in prior years constituted members of a consolidated group may be appropriate in certain situations.

The preamble states in relevant part:

> Finally, the Treasury Department will study further whether it is appropriate to aggregate the income and losses of ineligible members in certain cases. For instance, notwithstanding the ordinary reading of section 1503(c)(2), it may be consistent with the intent of section 1503(c)(2), or correct as a matter of policy, to aggregate the income and losses of ineligible members that filed a consolidated return prior to their acquisition by * * * another group that files a consolidated return. [T.D. 7877, 1983-1 C.B. 207, 212.]

Due primarily to the presence of the above reserved subparagraph for acquired consolidated groups and due to the above language from the preamble to the regulations, petitioners argue that the separate entity treatment for ineligible nonlife companies that is provided in section 1503(c)(2) and section 1.1502-47(m)(3)(vi), Income Tax Regs., should itself be limited and should not apply to ineligible nonlife companies that previously constituted an affiliated group and that filed consolidated Federal income tax returns (e.g., the companies that constituted members of the former INA and PHC groups).

Petitioners cite portions of the Department of the Treasury (Treasury) administrative files under section 1.1502-47(m)(3) and (4), Income Tax Regs., that suggest that the insurance industry in general and petitioners in particular were engaged with respondent and the Treasury over a period of years in extensive discussions regarding whether a separate or a single entity method should be adopted and reflected in the regulations with regard to the treatment of losses of ineligible nonlife companies that constituted part of a previously affiliated and consolidated group. Portions of the referenced administrative files also reflect positions or recommendations of various Government officials about the separate or single entity method and indicate that some Government officials at one time or another favored a single entity method.

Petitioners argue that the administrative files establish that, in the regulations, the Treasury and respondent never adopted a final decision as to how to treat losses of ineligible nonlife companies that constituted part of a previously affiliated and consolidated group and that the "reserved" subparagraph (4) under section 1.1502-47(m), Income Tax Regs., was intended to preserve this issue until that subparagraph was promulgated.

Petitioners further argue that in the absence of a rule under the regulations as to how to treat losses of ineligible nonlife companies that constituted part of a previously affiliated and consolidated group, the statutory and regulatory provisions are

unclear and ambiguous, and petitioners should be entitled to treat losses of the respective ineligible nonlife companies that constituted members of the former INA and PHC groups under any reasonable interpretation of the statute. Petitioners then argue that treating members of the former INA group and members of the former PHC group as two single nonlife entities constitutes a reasonable approach.

Additionally, if we agree with respondent's interpretation of section 1.1502-47(m)(3)(vi), Income Tax Regs., with regard to the companies that constituted members of the former INA and PHC groups, petitioners argue that the regulation should be invalidated.

Petitioners also argue that a calculation of the ineligible CNOL's using respondent's separate entity method would cause an increased overall tax liability for the CIGNA group, as compared to the collective tax liabilities of the CIGNA group and the former INA and PHC groups, assuming the former INA and the PHC groups had never been acquired. Petitioners thus conclude that any such calculation would constitute an improper, punitive calculation.

We disagree with each of petitioners' arguments.

We agree with respondent's interpretation of the statutory and regulatory provisions involved in these cases. As indicated, section 1503(c)(1) provides generally that losses of ineligible nonlife companies may be used to reduce income of life companies but only pursuant to regulations promulgated by the Treasury and subject to the limitations contained in section 1503(c)(1) and (2). Also as indicated, the legislative regulations that were promulgated by the Treasury generally reflect a separate entity method when calculating, under section 1503(c)(2), the amount of nonlife losses that are to be attributed to ineligible nonlife companies and therefore that may not be used to reduce income of life companies. The statute and the regulations do not reflect any special treatment

for losses of ineligible nonlife companies that previously constituted an affiliated and consolidated group.

We regard the "reserved" subparagraph (4) under section 1.1502- 47(m), Income Tax Regs., as a neutral factor. That provision simply reserves a space for regulations that may be promulgated at a later date and that may provide a special rule with regard to losses of ineligible nonlife companies that previously constituted an affiliated and consolidated group.

We regard the preamble language to the regulations as merely reflecting the Treasury's willingness to study whether a special rule should be promulgated for acquired previously affiliated and consolidated groups. That language is not to be construed as indicating that section 1.1502-47(m)(3)(vi), Income Tax Regs., and the separate entity method reflected therein do not apply to ineligible nonlife companies that previously constituted an affiliated and consolidated group.

Petitioners' arguments that are based on certain material in the Treasury's administrative files under section 1.1502-47(m)(3) and (4), Income Tax Regs., are not persuasive. The documents from the administrative files are not compelling, consistent, or clear as to the intended treatment of losses of ineligible nonlife companies that constituted part of a previously affiliated and consolidated group. Also, the relied-upon material from the administrative files reflects generally only personal views of various Government representatives, not official statements of respondent or of the Treasury. *See Armco, Inc. v. Commissioner*, 87 T.C. 865, 867-868 (1986).

In any event, personal views of such Government representatives would not be able to overcome the particular statutory and regulatory scheme before us in these cases. In light of this statutory and regulatory scheme, petitioners' alleged factual matter in dispute (namely, the intent of such Government representatives) is simply not sufficiently relevant

to the resolution of the issue to give rise to a genuine issue of material fact. Rule 121(b).

We emphasize that section 1503(c)(1) provides that nonlife losses may be taken into account only "under regulations prescribed by the Secretary". Assuming arguendo that the above reserved subparagraph (4) of section 1.1502-47(m), Income Tax Regs., was intended and should be construed as petitioners would have us construe it (namely, as exempting from the general separate entity method of the regulations ineligible nonlife companies that previously had been members of an affiliated and consolidated group), petitioners arguably would be left without any specific regulatory provision that would support their single entity method for such nonlife companies. Because section 1503(c)(1) provides that nonlife losses may be taken into account only as provided in regulations, the absence of any such regulation might preclude petitioners from taking into account any of the losses of the ineligible nonlife companies that previously constituted members of the former INA and PHC groups. *See Estate of Neumann v. Commissioner*, 106 T.C. 216, 219-221 (1996); *H Enters. Intl., Inc. v. Commissioner*, 105 T.C. 71, 81-83 (1995); *Alexander v. Commissioner*, 95 T.C. 467, 473 (1990), *aff'd without published opinion sub nom. Stell v. Commissioner*, 999 F.2d 544 (9th Cir. 1993).

We simply are not persuaded by petitioners' arguments. As indicated, the regulations in question are legislative in nature. Pursuant to sections 1502 and 1503(c)(1), the Treasury was given an express delegation of regulatory authority. Respondent's interpretation of the legislative regulations in these cases is sufficiently consistent with section 1503(c)(2) and its legislative purpose to restrict the use of ineligible nonlife losses against life income. Also, respondent's interpretation is not so clearly inconsistent with the statute or its purpose as to be arbitrary and capricious and invalid. *See Chevron, U.S.A.*,

Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844 (1984).

Finally, petitioners' argument as to the punitive effect of the separate entity method does not justify a different result. Under the separate entity method, the CIGNA group still obtains benefits in consolidating nonlife and life companies (i.e., the ability to offset some nonlife losses against life income). Also, as indicated, section 1.1502-47(m)(3)(vi), Income Tax Regs., is consistent with congressional intent to place some limits on the use of ineligible nonlife losses to reduce income of life companies. Further, under the regulations, ineligible losses of nonlife companies are not completely lost, and such losses may be carried back or forward and used to reduce consolidated taxable income of nonlife companies in other years. Sec. 1.1502- 47(m)(3)(vii), Income Tax Regs.

For the reasons stated, we conclude that, for the years in issue, section 1.1502-47(m)(3)(vi), Income Tax Regs., applies to the companies that previously constituted members of the former INA and PHC groups for purposes of calculating the amount of losses of the nonlife companies of the CIGNA group that may be used to reduce the income of ConnLife. The CIGNA group is required to treat each of the nonlife companies that previously constituted members of the former INA and the former PHC groups as a separate entity.

We also conclude that no factual matter remains in dispute that precludes our granting summary judgment in favor of respondent.

We have considered petitioners' other arguments and find them unpersuasive.

To reflect the foregoing,

Appropriate orders and decisions will be entered for respondent.

PERTINENT STATUTORY AND REGULATORY PROVISIONS

TITLE 26—INTERNAL REVENUE CODE (1994)

CHAPTER 6 — CONSOLIDATED RETURNS

Subchapter A—Returns and Payment of Tax

26 U.S.C. § 1501. Privilege to file consolidated returns

An affiliated group of corporations shall, subject to the provisions of this chapter, have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

26 U.S.C. § 1502. Regulations

The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

26 U.S.C. § 1503. Computation and payment of tax

(a) [General rule][1]

In any case in which a consolidated return is made or is required to be made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under section 1502 prescribed before the last day prescribed by law for the filing of such return.

[(b) Repealed. Pub. L. 94-455, title X, § 1052(c)(5), Oct. 4, 1976, 90 Stat. 1648]

(c) Special rule for application of certain losses against income of insurance companies taxed under section 801

(1) In general

If an election under section 1504(c)(2) is in effect for the taxable year and the consolidated taxable income of the members of the group not taxed under section 801 results in a consolidated net operating loss for such taxable year, then under regulations prescribed by the Secretary, the amount of such loss which cannot be absorbed in the applicable carryback periods against the taxable income of such members not taxed under section 801 shall be taken into account in determining the consolidated taxable income of the affiliated group for such taxable year to the extent of 35 percent of such loss or 35 percent of the taxable income of the members taxed under section 801, whichever is less. The unused portion of such loss shall be available as a carryover, subject to the same limitations (applicable to the sum of the loss for the carryover year and the loss (or losses) carried over to such year), in applicable carryover years.

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[1] Subsec. (a) heading editorially supplied.

(2) Losses of recent nonlife affiliates

Notwithstanding the provisions of paragraph (1), a net operating loss for a taxable year of a member of the group not taxed under section 801 shall not be taken into account in determining the taxable income of a member taxed under section 801 (either for the taxable year or as a carryover or carryback) if such taxable year precedes the sixth taxable year such members have been members of the same affiliated group (determined without regard to section 1504(b)(2)).

* * *

26 U.S.C. § 1504. Definitions

(a) Affiliated group defined

For purposes of this subtitle—

(1) In general

The term "affiliated group" means—

(A) 1 or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if—

(B)(i) the common parent owns directly stock meeting the requirements of paragraph (2) in at least 1 of the other includible corporations, and

(ii) stock meeting the requirements of paragraph (2) in each of the includible corporations (except the common parent) is owned directly by 1 or more of the other includible corporations.

* * *

(b) Definition of "includible corporation"

As used in this chapter, the term "includible corporation" means any corporation except—

(1) Corporations exempt from taxation under section 501.

(2) Insurance companies subject to taxation under section 801.

* * *

(c) Includible insurance companies

Notwithstanding the provisions of paragraph (2) of subsection (b)—

(1) Two or more domestic insurance companies each of which is subject to tax under section 801 shall be treated as includible corporations for purposes of applying subsection (a) to such insurance companies alone.

(2)(A) If an affiliated group (determined without regard to subsection (b)(2)) includes one or more domestic insurance companies taxed under section 801, the common parent of such group may elect (pursuant to regulations prescribed by the Secretary) to treat all such companies as includible corporations for purposes of applying subsection (a) except that no such company shall be so treated until it has been a member of the affiliated group for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed.

* * *

26 U.S.C. § 1505. Cross references

* * *

26 C.F.R. § 1.1502-47 Consolidated returns by life-nonlife groups.

(a) ***Scope*** — (1) *In general.* Under section 1504(b)(2), insurance companies that are taxed under section 802 or 821 (relating respectively to life insurance companies and to certain mutual insurance companies) are not treated as includible

corporations for purposes of determining under section 1504(a) the existence of an affiliated group and the composition of its membership. Section 1504(c)(2) provides an election whereby certain life insurance companies and mutual insurance companies may be treated as includible corporations, and thus members, of a group composed of other includible corporations. This section provides regulations for the making of this election and for the determination of an electing group's composition and its consolidated tax liability.

(2) *General method of consolidation* — (i) Subgroup method. The regulations adopt a subgroup method to determine consolidated taxable income. One subgroup is the group's nonlife companies (including those taxable under section 821). The other subgroup is the group's life insurance companies. Initially, the nonlife subgroup computes nonlife consolidated taxable income and the life subgroup computes consolidated partial life insurance company taxable income. A subgroup's income may in effect be reduced by a loss of the other subgroup. The life subgroup losses consist of consolidated loss from operations and life consolidated net capital loss. The nonlife subgroup losses consist of nonlife consolidated net operating loss and nonlife consolidated net capital loss. Consolidated taxable income is therefore defined in pertinent part as the sum of nonlife consolidated taxable income and consolidated partial life insurance company taxable income reduced by life subgroup losses or nonlife subgroup losses.

(ii) *Subgroup loss*. A subgroup loss does not actually affect the computation of nonlife consolidated taxable income or consolidated partial life insurance company taxable income. It merely constitutes a bottom-line adjustment in reaching consolidated taxable income. Furthermore, one subgroup's loss must first be carried back against income of the same subgroup before it may be used as a setoff against the second subgroup income in the taxable year the loss arose. (See section 1503(c)(1)). The carryback of the losses from one

subgroup may not be used to offset income of the other subgroup in the year to which the loss is to be carried. This carryback of the first subgroup's loss may "bump" the second subgroup's loss that in effect previously reduced the income of the first subgroup. The second subgroup's loss that is bumped in appropriate cases may in effect reduce a succeeding year's income of the second or first subgroup. This approach gives the group the tax savings of the use of losses but the bumping rule assures that insofar as possible life deductions will be matched against life income and nonlife deductions against nonlife income.

(iii) *Carryover of subgroup loss.* A subgroup's loss may be used in a succeeding year, but in any particular succeeding year the loss must be used to reduce the income of the same subgroup before it may be used as a setoff against the other subgroup's income.

(3) *Authority.* This section is prescribed under the authority of sections 1502, 1503(c), 1504(c)(2), and 7805(b).

(4) *Other provisions.* The provisions of §§ 1.1502-1 through 1.1502-80 apply unless this section provides otherwise. Further, unless otherwise indicated in this section, a term used in this section has the same meaning as in sections 801-844.

(b) ***Effective date.*** This section is effective for taxable years for which the due date (without extensions) for filing returns is after March 14, 1983.

(c) ***Cross references.*** The following table provides cross references for some of the definitions and operating rules that are relevant in making the election and determining the group's composition and its tax liability:

* * *

(d) Definitions. For purposes of this section:

(1) *Life insurance company.* The term "life company"

means a life insurance company as defined in section 801. Section 801 applies to each company separately.

(2) *Mutual insurance company*. The term "mutual company" means a mutual insurance company taxable under section 821(a)(1).

(3) *Life insurance company taxable income*. The term "life insurance company taxable income" is referred to as LICTI. The terms "TII", "GO", and "LO" refer, respectively, to taxable investment income (section 804), gain from operations (section 809), and loss from operations (section 812). The term "consolidated partial LICTI" refers to consolidated LICTI without section 802(b)(3).

(4) *Group*. The term "group" means an affiliated group of corporations (as defined in section 1504(a)). Unless otherwise indicated in this section, a group's composition is determined without section 1504(b)(2).

(5) *Member*. The term "member" means a corporation (including the common parent) that is an includible corporation in the group. A life company or mutual company is tentatively treated as a member for any taxable year for purposes of determining if it is an eligible corporation under paragraph (d)(12) of this section and therefore if it is an includible corporation under section 1504(c)(2). If such a company is eligible and includible (under section 1504(c)(2)), it will actually be treated as a member of the group.

(6) *Life member*. A life member is a member of the group that is a life company.

(7) *Nonlife member*. A nonlife member is a member of the group that is not a life company.

(8) *Life subgroup*. A life subgroup is composed of those members that are life members. If the group has only one life member, it constitutes a life subgroup.

(9) *Nonlife subgroup.* A nonlife subgroup is composed of those members that are nonlife members. If the group has only one nonlife member, it constitutes a nonlife subgroup.

(10) *Separate return year.* The term "separate return year" means a taxable year of a corporation for which it files a separate return or for which it joins in the filing of a consolidated return by another group. For purposes of this subparagraph (10), the term "group" is defined with regard to section 1504(b)(2) for years in which an election under section 1504(c)(2) is not in effect. Thus, a separate return year includes a taxable year for which that election is not in effect.

(11) *Separate return limitation year.* Section 1.1502-1(f)(2) provides exceptions to the definition of the term "separate return limitation year". For purposes of applying those exceptions to this section, for taxable years ending after December 31, 1980, the term "group" is defined without regard to section 1504(b)(2) and the definition in this subparagraph (11) applies separately to the nonlife subgroup in determining nonlife consolidated taxable income under paragraph (h) of this section and to the life subgroup in determining consolidated partial LICTI under paragraph (j) of this section. Paragraph (m)(3)(ix) of this section defines the term "separate return limitation year" for purposes of determining whether the losses of one subgroup may be used against the income of the other subgroup.

(12) *Eligible corporations* — (i) *In general.* A corporation is an eligible corporation for a taxable year of a group only if, throughout every day of the base period the corporation:

(A) Was in existence and a member of the group determined without the exclusions in section 1504(b)(2) (see paragraphs (d)(12)(iii)-(vi) of this section),

(B) Was engaged in the active conduct of a trade or business ("active business"),

(C) Did not experience a change in tax character (see paragraph (d)(12)(vii) of this section), and

(D) Did not undergo disproportionate asset acquisitions (see paragraph (d)(12)(viii) of this section).

(ii) *Base period.* The base period consists of the common parent's five taxable years immediately preceding the group's taxable year for which the consolidated return and the determination of eligibility are made. Eligibility is determined for each consolidated return year beginning with the first year for which the election under section 1504(c)(2) is effective.

(iii) *In existence.* Except as provided in paragraph (d)(12)(v) and (vi) of this section, a corporation organized after the base period begins is not eligible even though it is a member of the group immediately after its organization. For purposes of this subdivision (iii), a corporation that was a party to a reorganization described in section 368(a)(1)(F) shall be treated as the same entity both before and after the reorganization.

(iv) *Membership period.* Except as provided in paragraph (d)(12)(v) and (vi) of this section, a corporation must have been a member of the group throughout the base period to be eligible. Thus, an ineligible corporation includes one whose stock was acquired from outside the group at any time during the base period or one which was a member of a different group (whether by application of reverse acquisition rules in § 1.1502-75(d)(3) or otherwise) at any time during the base period. For purposes of this subdivision (iv), the common parent of a group is treated as constituting a group (and hence is a member) during any period when it was not a member of an affiliated group within the meaning of section 1504(a) (applied without section 1504(b)(2)).

(v) *Tacking rule.* The period during which an "old" corporation is in existence and a member of the group engaged in active business is included in (or "tacks" onto) the period for the "new" corporation if the following five conditions listed in

this subdivision (v) are met. For purposes of this subparagraph (12), a "new" corporation is a corporation (whether or not newly organized) during the period its eligibility depends upon the tacking rule. The five conditions are as follows:

(A) The first condition is that, at any time, 80 percent or more of the new corporation's assets it acquired (other than in the ordinary course of its trade or business) where acquired from the old corporation in one or more transactions described in section 351(a) or 381(a). This asset test is applied by using the fair market values of assets on the date they were acquired and without regard to liabilities. Assets acquired in the ordinary course of business will be excluded from total assets only if they were acquired after the new corporation became a member of the group (determined without section 1504(b)(2)). In addition, assets that the old corporation acquired from outside the group in transactions not conducted in the ordinary course of its trade or business are not included in the 80 percent (but are included in total assets) if the old corporation acquired those assets within five calendar years before the date of their transfer to the new corporation.

(B) The second condition is that at the end of the taxable year during which the first condition is first met, the old corporation and the new corporation must both have the same tax character. For purposes of this paragraph (d)(12), a corporation's tax character is the section under which it would be taxed (i.e., sections 11, 802, 821, or 831) if it filed a separate return. If the old corporation is not in existence (or adopts a plan of complete liquidation) at the end of that taxable year, this subdivision (v)(B) will apply to the old corporation's taxable year immediately preceding the beginning of the taxable year during which the first condition is first met.

(C) The third condition is that, if the old and new corporation are life insurance companies, the transfer (or transfers) is not reasonably expected (at the time of the

transfer) to result in the separation of profitable activities from loss activities.

(D) The fourth condition is that, at the end of the taxable year during which the first condition is first met, the new corporation does not undergo a disproportionate asset acquisition under paragraph (d)(12)(viii) of this section.

(E) The fifth condition is that, if there is more than one old corporation, the first three conditions apply to all of the corporations. Thus, the second condition (tax character) must be met by all of the old corporations transferring assets taken into account in meeting the test in paragraph (d)(12)(v)(A) of this section.

(vi) *Old group remaining in existence.* If the common parent of a group (or a new common parent) became the common parent in a transaction described in § 1.1502-75(d)(2) or (d)(3) where a group remained in existence, then paragraph (d)(12)(ii)-(iv) of this section apply by treating that common parent as if it were also the previous common parent of the group that remains in existence. If this paragraph (d)(12)(vi) applies to a transaction, the tacking rule in paragraph (d)(12)(v) of this section does not apply to the transaction.

(vii) *Change in tax character.* A corporation must not experience during the base period a change in tax character (as defined in paragraph (d)(12)(v)(B) of this section) if the change is attributable to an acquisition of assets from outside the group in transactions not conducted in the ordinary course of its trade or business. However, if a new corporation relies on the tacking rules in paragraph (d)(12)(v) of this section, this paragraph (d)(12)(vii) shall apply during the base period and the current consolidated return year and even if the change in tax character is attributable to an asset acquisition from within the group.

(viii) *Disproportionate asset acquisition.* To be eligible, a corporation must not undergo during the base period dispro-

portionate asset acquisitions which are attributable to an acquisition (or a series of acquisitions) of assets from outside the group in transactions not conducted in the ordinary course of its trade or business (special acquisition). Whether special acquisitions are disproportionate is determined at the end of each base period. Whether an acquisition results in a disproportionate asset acquisition depends on all of the facts and circumstances including the following factors and rules:

(A) One factor is the portion of the insurance reserves (i.e., total reserves in section 801(c)) of the acquiring company at the end of the base period which is attributable to special acquisitions.

(B) A second factor is the portion of the fair market value of the assets (without reduction for liabilities) of the acquiring company at the end of the base period that is attributable to special acquisitions.

(C) A third factor is the portion of the premiums generated during the last taxable year of the base period which are attributable to special acquisitions.

(D) A corporation will not experience a disproportionate asset acquisition unless 75 percent of one factor (whether or not listed in this subdivision (viii)) is attributable to special acquisitions.

(E) Money or other property contributed to a corporation by a shareholder that is not a member of the group (without section 1504(b)(2)) is not a special acquisition.

(F) If a new corporation relies on the tacking rules in paragraph (d)(12)(v) of this section, this subdivision (viii) applies to that corporation during a consolidated return year. Thus, if at any time during a consolidated return year, a new corporation undergoes a disproportionate asset acquisition, the corporation becomes ineligible at that time.

(13) *Ineligible corporation.* A corporation that is not an eligible corporation is ineligible. If a life company or mutual company is ineligible, it is not treated under section 1504(c)(2) as an includible corporation. Losses of a nonlife member arising in years when it is ineligible may not be used under section 1503(c)(2) and paragraph (m) of this section to set off the income of a life member. If a life or mutual company is ineligible and is the common parent of the group (without section 1504(b)(2)), the election under section 1504(c)(2) may not be made.

(14) *Illustrations.* The following examples illustrate this paragraph (d).

* * *

(e) ***Election*** — (1) *In general.* The election under section 1504(c)(2) may not be made if the group's common parent is an ineligible life company or an ineligible mutual company. The election under section 1504(c)(2) may only be made by the common parent of the group (as defined in section 1504(c)(2) without the exclusions in section 1504(b)(2)). For example, assume that P owns all of the stock of L sub1, an eligible life company, which owns the stock of S sub1. Assume further that P also owns the stock of L sub2, an ineligible life member, which (for more than five years) has owned the stock of a nonlife company, S sub2. Only P may make the election and, if it does so, P, L sub1, and S sub1 may file a consolidated return under this section. L sub2 may not make the election under section 1504(c)(2) and may not file a consolidated return with S sub2.

(2) *How election is made* — (i) General rule. The election under section 1504(c)(2) is generally made by the group's common parent in the same manner (and it has the same effect) as the election to file a consolidated return is made under § 1.1502-75 (a) and (b) for a group which did not file a consolidated return for the immediately preceding taxable year.

The procedure for making the election under section 1504(c)(2) is the same whether or not a consolidated return was filed by the life members or the nonlife members for the immediately preceding taxable year.

(ii) *Special rule.* Notwithstanding the general rule, however, if the nonlife members in the group filed a consolidated return for the immediately preceding taxable year and had executed and filed a Form 1122 that is effective for the preceding year, then such members will be treated as if they filed a Form 1122 when they join in the filing of a consolidated return under section 1504(c)(2) and they will be deemed to consent to the regulations under this section. However, an affiliation schedule (Form 851) must be filed by the group and the life members must execute a Form 1122 in the manner prescribed in § 1.1502- 75(h)(2).

(3) *Irrevocability.* Except as provided in § 1.1502-75(c) and paragraph (e)(4) of this section, the election under section 1504(c)(2) is irrevocable.

(4) *Permission to discontinue* — (i) *General rule.* A "section 1504(c)(2) group" with a common parent that has made the election to file a consolidated return under section 1504(c)(2) in a previous taxable year is granted permission to elect (under § 1.1502-75(c)(2)(ii)) to discontinue filing such a consolidated return for that group's first taxable year for which the regulations under this section are effective. This election to discontinue shall be exercised in the time and manner prescribed in § 1.1502-75(c)(3), except that the group's common parent shall exercise this election to discontinue (and the other members of the section 1504(c)(2) group must comply with this election) by filing appropriate returns. For purposes of this paragraph (e)(4), an appropriate return is either a separate return or a consolidated return that is filed by newly exercising the privilege under § 1.1502-75(a)(1).

(ii) *Types of groups.* (A) A "section 1504(c)(2) group" is an affiliated group which files or filed a consolidated return pursuant to an election under section 1504(c)(2).

(B) A "limited group" is an affiliated group (determined without section 1504(c)(2)) having at least one member which was a member of a section 1504(c)(2) group on the date that the section 1504(c)(2) group elected to discontinue under paragraph (e)(4)(i) of this section.

(iii) *Effect on restoration rules.* If a group ceases to file a consolidated return or terminates or if a member leaves the group, certain items of income, gain, or loss on transactions between members are taken into account under §§ 1.1502-13, 1.1502-18, and 1.1502-19 ("restoration rules"). For purposes of applying these restoration rules solely by reason of an election under paragraph (e)(4)(i) or (e)(4)(v)(A) of this section to discontinue filing consolidated returns as a section 1504(c)(2) group, the following rules apply:

(A) The section 1504(c)(2) group shall not be considered to terminate and no member of that group shall be treated as ceasing to be a member.

(B) Members of that section 1504(c)(2) group that are included in the consolidated return of a limited group for the first taxable year for which the discontinuance is effective shall be considered to be filing a consolidated return as a continuation of the section 1504(c)(2) group. However, a corporation that is not a member of a particular limited group for that taxable year is considered to have a separate return year (and, for purposes of § 1.1502-19(c), not to be a member of a group filing a consolidated return) with respect to that limited group's members.

(C) Section 1.1502-13 shall be applied without regard to paragraph (f)(1)(vii).

(iv) *Illustrations.* The following examples illustrate paragraph (e)(4)(i)- (iii) of this section.

* * *

(v) *Additional rules.* (A) If a group with a taxable year ending in the month of December, 1982, had made the election under section 1504(c)(2) for a taxable year ending prior to December 1, 1982, and if that group meets the conditions of subdivision (vi) of this paragraph (e)(4), then the common parent may elect to discontinue filing a consolidated return for its taxable year ending in the month of December, 1982 (and other members of the section 1504(c)(2) group must comply with this election) by filing appropriate returns (see paragraph (e)(4)(i) of this section) before September 16, 1983.

(B) If a group made the election under section 1504(c)(2) for its taxable year ending in the month of December, 1982, and if that group meets the conditions of subdivision (vi) of this paragraph (e)(4), then the common parent may elect to withdraw the section 1504(c)(2) election (and all other members of the group determined without section 1504(b)(2) comply with the election) by filing before September 16, 1983, any returns for the appropriate taxable years that would have been filed had the section 1504(c)(2) election never been made.

(vi) A group referred to at subdivision (v)(A) or (B) of this paragraph (e)(4) meets the conditions of this subdivision (vi) if it —

(A) Filed before March 16, 1983, a return for its taxable year ending in the month of December, 1982, and

(B) Had not been granted an extension of time beyond March 15, 1983, for the filing of that return.

(vii) *Interest.* For purposes of section 6601(a), interest runs from the original due date (without extensions) for the filing of such returns as are filed pursuant to an election (to

discontinue or withdraw as the case may be) under this paragraph (e)(4).

(5) *Consent to regulations.* If a group does not discontinue filing a consolidated return under paragraph (e)(4) of this section but continues to file a consolidated return for the group's first taxable year for which the regulations under this section are first effective, the members of the group will be deemed to have consented to the regulations under this section.

(6) *Cross reference.* If an election is made under section 1504(c)(2), see § 1.1502-75(e) and (f) for rules that apply for not including (or including) a member or a nonmember in the consolidated return.

(f) ***Effect of election.*** If the common parent makes the election under section 1504(c)(2), the following rules apply:

(1) *Termination of group.* A mere election under section 1504(c)(2) will not cause the creation of a new group or the termination of an affiliated group that files a consolidated return in the immediately preceding taxable year.

(2) *Effect of eligibility.* If a life member is eligible after an election under section 1504(c)(2), it may not be included as a member of an affiliated group as defined in section 1504(c)(1).

(3) *Eligible and ineligible life companies.* If any life company was a member of an affiliated group of life companies (as defined in section 1504(c)(1)) but is ineligible for a taxable year for which the election under section 1504(c)(2) is effective, that year is not a separate return year merely by reason of the election under section 1504(c)(2) in applying §§ 1.1502-13, 1.1502-18, and 1.1502-19 to transactions occurring in prior consolidated return years of that affiliated group. In addition, if more than one ineligible life member of the group (as defined in section 1504(c)(1)) joined in the filing of a consolidated return in the taxable year immediately preceding the year for which the election under section

1504(c)(2) is effective and, solely as a result of the election, one of the ineligible life members becomes the common parent of such a group (section 1504(c)(1)), the group must continue to file a consolidated return. For example, assume that L sub1 owns all of the stock of S sub1 and all of the stock of L sub2. L sub2 owns the stock of L sub3. L sub1, L sub2, and L sub3 are life companies and S sub1 is a nonlife company. Assume further that in 1981, L sub1, L sub2, and L sub3 file a consolidated return but L sub1 makes the election under section 1504(c)(2) for 1982 and L sub2 and L sub3 are ineligible. L sub2 and L sub3 must continue to file a consolidated return in 1982. Moreover, L sub2 could elect in 1982 to file a consolidated return (section 1504(c)(1)) with L sub3 even if they did not file a consolidated return in 1981 with L sub1.

(4) *Inclusion of life company.* If a life company is ineligible in the consolidated return year for which the election is effective, it will be treated as an includible corporation for the common parent's first taxable year in which the company becomes eligible.

(5) *Dividends received deduction.* Section 243(b)(5) defines the term affiliated group for purposes of the election to deduct 100 percent of the qualifying dividends received by a member from another member of the group. Section 246(b)(6) limits certain multiple tax benefits and the deduction itself. Section 243(b)(5) and (6) do not apply to the mutual companies and life companies that are eligible corporations. See section 1504(c)(2)(B)(i). Thus, the common parent of the group may elect to deduct 100 percent of the qualifying dividends received from an ineligible life company.

(6) *Controlled group.* Sections 1563(a)(4), (b)(2)(D), and (b)(3)(C) (insofar as it applies to corporations described in section 1563(b)(2)(D)) do not apply to any eligible or ineligible life company that is a member of the group for a taxable year

during which the election is effective. See paragraph (d)(4) of this section for the definition of group.

(7) *Consolidated tax*. The tax liability of a group for a consolidated return year (before application of credits against that tax) is computed on a consolidated basis by adding together the following taxes:

(i) The tax imposed under section 11 on consolidated taxable income (as determined under paragraph (g) of this section). The taxes imposed under sections 802(a), 821(a), and 831(a) will each be treated as a tax imposed under section 11.

(ii) The tax imposed by section 1201 on consolidated net capital gain (as determined under paragraph (o) of this section) in lieu of the tax imposed under paragraph (f)(7)(i) of this section on that gain.

(iii) Any taxes described in § 1.1502-2 (other than by paragraphs (a), (f), and (h) thereof).

(g) ***Consolidated taxable income***. The consolidated taxable income is the sum of the following three amounts:

(1) *Nonlife consolidated taxable income*. The nonlife consolidated taxable income (as defined in paragraph (h) of this section) of the nonlife subgroup, as set off by the life subgroup losses as provided in paragraph (n) of this section. The amount in this paragraph (g)(1) may not be less than zero.

(2) *Consolidated partial LICTI*. The consolidated partial LICTI (as defined in paragraph (j) of this section) of the life subgroup, as set off by the nonlife subgroup losses as provided in paragraph (m) of this section. The amount in this paragraph (g)(2) may not be less than zero.

(3) *Surplus accounts*. The sum of the amounts subtracted under section 815 from the policyholders' surplus accounts of the life members.

(h) ***Nonlife consolidated taxable income*** — (1) *In general.* Nonlife consolidated taxable income is the consolidated taxable income of the nonlife subgroup, computed under § 1.1502-11 as modified by this paragraph (h). For this purpose, separate taxable income of a member includes separate mutual insurance company taxable income (as defined in section 821(b)) and insurance company taxable income (as defined in section 832).

(2) *Nonlife consolidated net operating loss deduction* — (i) *In general.* In applying §§ 1.1502-21 or 1.1502-21A (as appropriate), the rules in this subparagraph (2) apply in determining for the nonlife subgroup the nonlife net operating loss and the portion of the nonlife net operating loss carryovers and carrybacks to the taxable year.

(ii) *Nonlife CNOL.* The nonlife consolidated net operating loss is determined under §§ 1.1502-21(A)(f) or 1.1502-21(e) (as appropriate) by treating the nonlife subgroup as the group.

(iii) *Carryback.* The nonlife consolidated net operating loss for the nonlife subgroup is carried back under §§ 1.1502-21A or 1.1502-21 (as appropriate) to the appropriate years (whether consolidated or separate) before the loss may be used as a nonlife subgroup loss under paragraphs (g)(2) and (m) of this section to set off consolidated partial LICTI in the year the loss arose. The election under section 172(b)(3)(C) to relinquish the entire carryback period for the net operating loss of the nonlife subgroup may be made by the common parent of the group. Furthermore, the election may be made even though the election under section 812(b)(3) and paragraph (l)(3)(iii) of this section is not made.

(iv) *Subgroup rule.* In determining the portion of the nonlife consolidated net operating loss that is absorbed when the loss is carried back to a consolidated return year beginning after December 31, 1981, §§ 1.1502-21A or 1.1502-21 (as appropriate) is applied by treating the nonlife subgroup as the

group. Therefore, the absorption is determined without taking into account any life subgroup losses that were previously reported on a consolidated return as setting off nonlife consolidated taxable income for the year to which the nonlife loss is carried back.

(v) *Carryover.* The portion of the nonlife consolidated net operating loss that is not absorbed in a prior year as a carryback, or as a nonlife subgroup loss that set off consolidated partial LICTI for the year the loss arose, constitutes a nonlife carryover under this subparagraph (2) to reduce nonlife consolidated taxable income before that portion may constitute a nonlife subgroup loss that sets off consolidated partial LICTI for a particular year.

(vi) *Transitional rules.* The nonlife consolidated net operating loss deduction is subject to a transitional rule limitation in paragraph (h)(3) of this section.

(vii) *Example.* The following example illustrates this paragraph (h)(2).

* * *

(3) *Transitional rule* — (i) *In general.* The portion of the nonlife consolidated net operating loss deduction in a consolidated return year beginning after December 31, 1980 (referred to as "post-1980 year") attributable to net operating losses sustained in separate return years ending before January 1, 1981 (referred to as "pre-1981 year"), is subject to the rules and limitations in this subparagraph (3).

(ii) *Separate nonlife groups.* To determine the limitation, first, identify for the post-1980 year one or more separate affiliated groups of nonlife companies (as defined in section 1504 without section 1504(c)(2)). For this purpose, a single nonlife company may constitute a separate affiliated group if (A) it is not otherwise a member of a separate group or (B) it has a net operating loss sustained in the pre-1981 year that may

be carried over and that year is a separate return limitation year (determined under § 1.1502-1(f) without paragraph (d)(11) of this section).

(iii) *Carryover.* Second, identify the pre-1981 year net operating losses that may be carried over and that are attributable to each separate affiliated group of nonlife companies. The separate return limitation year rules in §§ 1.1502- 21A(c) or 1.1502-21(c) (as appropriate) do not apply to any of these carryovers.

(iv) *Limitation.* Third, treat the last taxable year ending before January 1, 1981, as if in that year there was a consolidated return change of ownership of each such separate affiliated group of nonlife companies and apply the consolidated return change of ownership limitation in § 1.1502-21A(d) to the losses of each group by treating the members of each separate group as old members.

(v) *Examples.* The following examples illustrate this paragraph (h)(3).

* * *

(4) *Nonlife consolidated capital gain net income or loss* — (i) *In general.* In applying §§ 1.1502-22 or 1.1502-22A (as appropriate), the rules in this subparagraph (4) apply in determining for the nonlife subgroup the nonlife consolidated capital gain net income or loss and the portion of the nonlife net capital loss carryovers and carrybacks to the taxable year. In particular, the nonlife consolidated capital gain net income and nonlife consolidated net capital loss are determined under the principles of §§ 1.1502-22 or 1.1502- 22A(a) (as appropriate) by treating the nonlife subgroup as the group.

(ii) *Additional principles.* In applying §§ 1.1502-22A or 1.1502-22 to nonlife consolidated net capital loss carryovers and carrybacks, the principles set forth in paragraphs (h)(2)(iii) through (v) for applying §§ 1.1502-21 or 1.1502-21A (as

appropriate) to nonlife consolidated net operating loss carryovers and carrybacks shall also apply. Further, the portion of nonlife consolidated net capital loss carryovers attributable to losses sustained in taxable years ending before January 1, 1981, is subject to the limitations in paragraph (h)(3) of this section applied by substituting "net capital loss" for the term "net operating loss" and "§ 1.1502-22A(d)" for "§ 1.1502-21A(d)".

(iii) *Special rules.* The nonlife consolidated net capital loss is reduced, for purposes of determining the carryovers and carrybacks under §§ 1.1502- 22A(b)(1) or 1.1502-22(b) by the lesser of:

(A) The aggregate of the additional capital loss deductions allowed under section 822(c)(6) or section 832(c)(5), or

(B) The nonlife consolidated taxable income computed without capital gains and losses.

(i) [Reserved]

(j) ***Consolidated partial LICTI.*** [Reserved]

(k) ***Consolidated TII*** — (1) *General rule.* [Reserved]

(2) *Separate TII.* [Reserved]

(3) *Company's share of investment yield.* [Reserved]

(4) *Life consolidated capital gain net income.* [Reserved]

(5) *Life consolidated net capital loss carryovers and carrybacks.* The life consolidated net capital loss carryovers and carrybacks for the life subgroup are determined by applying the principles of §§ 1.1502-22 or 1.1502-22A (as appropriate) as modified by the following rules in this subparagraph (5):

(i) Life consolidated net capital loss is first carried back (or apportioned to the life members for separate return years) to be absorbed by life consolidated capital gain net income without regard to any nonlife subgroup capital losses and

before the life consolidated net capital loss may serve as a life subgroup capital loss that sets off nonlife consolidated capital gain net income in the year the life consolidated net capital loss arose.

(ii) If a life consolidated net capital loss is not carried back or is not a life subgroup loss that sets off nonlife consolidated capital gain net income in the year the life consolidated net capital loss arose, then it is carried over to the particular year under this paragraph (k)(5) first against life consolidated capital gain net income before it may serve as a life subgroup capital loss that sets off nonlife consolidated capital gain net income in that particular year.

(iii) *Section 818(f).* Capital losses may not be deducted more than once and capital gain will not be included more than once. See section 818(e) and also section 818(f).

(iv) Capital loss carryovers are subject to the transitional rule in paragraph (k)(6) of this section.

(6) *Transitional rule.* The portion of the life consolidated capital loss carryovers attributable to the net capital losses of the life members sustained in separate return years ending before January 1, 1981, is subject to the same limitations as the capital losses of nonlife members in paragraph (h)(4)(iii) of this section by applying the principles of paragraph (h)(3) of this section to each separate affiliated group of life companies.

(l) ***Consolidated GO or LO*** — (1) *General rule.* [Reserved]

(2) *Separate GO.* [Reserved]

(3) *Consolidated operations loss deduction* — (i) *General rule.* The consolidated operations loss deduction is an amount equal to the consolidated operations loss carryovers and carrybacks to the taxable year. The provisions of §§ 1.1502-21 or 1.1502-21A (as appropriate) and section 812 apply to the extent not inconsistent with this paragraph (l)(3).

(ii) *Consolidated offset*. For purposes of applying section 812(b) and (d), the term "consolidated offset" means the increase in the consolidated operations loss deduction which reduces consolidated partial LICTI to zero. For setoff of consolidated LO against nonlife consolidated taxable income, see paragraph (n)(2) of this section.

(iii) *Carrybacks*. A consolidated LO is first carried back to be absorbed by GO of a life member under section 809(d)(4) or consolidated partial LICTI (as the case may be under section 818(f)(2)) for prior consolidated return years (or apportioned to the life members for prior separate return years) without regard to any nonlife subgroup losses that were set off against consolidated partial LICTI and before the consolidated LO may serve as a life subgroup loss to be set off against nonlife consolidated taxable income in the year the consolidated LO arose. The election to relinquish the entire carryback period for the consolidated LO of the life subgroup may be made by the common parent of the group. See section 812(b)(3). Furthermore, the election may be made even though the election under section 172(b)(3)(C) and paragraph (h)(2)(iii) of this section is not made.

(iv) *Carryovers*. If a consolidated LO is not carried back or is not applied as a life subgroup loss that set off nonlife consolidated taxable income in the year the consolidated LO arose, then it is carried over to a particular year under this paragraph (l)(3) first against the GO of a life member under section 809(d)(4) or consolidated partial LICTI (as the case may be under section 818(f)(2)) before it may serve as a life subgroup loss that may be set off against nonlife consolidated taxable income for that particular year.

(v) *Transitional rule*. The portion of a consolidated operations loss deduction that is attributable to LOs sustained in separate return years ending before January 1, 1981, is subject to the same rules and limitations that the nonlife consolidated net operating loss deduction is subject to in

paragraph (h)(3) of this section as applied by identifying separate affiliated groups of life companies.

(4) *Life consolidated capital gain net income or loss.* Life consolidated capital gain net income or loss is determined in the same manner as under paragraph (k)(4) of this section. However, a life member's company share is determined under section 809(a) and (b)(3).

(m) ***Consolidated partial LICTI setoff by nonlife subgroup losses*** — (1) *In general.* The nonlife subgroup losses consist of the nonlife consolidated net operating loss and the nonlife consolidated net capital loss. Under paragraph (g)(2) of this section, consolidated partial LICTI is set off by the amounts of these two consolidated losses specified in paragraph (m)(2) of this section. The setoff is subject to the rules and limitations in paragraph (m)(3) of this section.

(2) *Amount of setoff* — (i) *Current year.* Consolidated partial LICTI for the current taxable year is set off by the portion of the nonlife consolidated net operating loss and nonlife consolidated net capital loss arising in that year that cannot be carried back under paragraph (h) of this section to prior taxable years (whether consolidated or separate return years) of the nonlife subgroup.

(ii) *Carryovers.* The portion of the offsetable nonlife consolidated net operating loss or nonlife consolidated net capital loss that has not been used as a nonlife subgroup loss setoff against consolidated partial LICTI in the year it arose may be carried over to succeeding taxable years under the principles of §§ 1.1502-21 or 1.1502-21A (as appropriate) (relating to net operating loss deduction) or §§ 1.1502-22 or 1.1502-22A (as appropriate) (relating to net capital loss carryovers). However, in any particular succeeding year, the losses will be used under paragraph (h) of this section in computing nonlife consolidated taxable income before being

used in that year as a nonlife subgroup loss that sets off consolidated partial LICTI.

(3) *Nonlife subgroup loss rules and limitations.* The nonlife subgroup losses are subject to the following operating rules and limitations:

(i) *Separate return years.* The carryovers in paragraph (m)(2)(ii) of this section may include net operating losses and net capital losses of the nonlife members arising in separate return years ending after December 31, 1980, that may be carried over to a succeeding year under the principles (including limitations) of §§ 1.1502-21 and 1.1502-22 (or §§ 1.1502-21A and 1.1502-22A, as appropriate). But see subdivision (ix) of this paragraph (m)(3).

(ii) *Capital loss.* Nonlife consolidated net capital loss sets off consolidated partial LICTI only to the extent of life consolidated capital gain net income (as determined under paragraph (l)(4) of this section) and this setoff applies before any nonlife consolidated net operating loss sets off consolidated partial LICTI.

(iii) *Capital gain.* Life consolidated capital gain net income is zero in any taxable year in which the life subgroup has a consolidated LO and, in any taxable year, it may not exceed consolidated partial LICTI.

(iv) *Ordering rule.* Consolidated partial LICTI for a consolidated return year is set off by nonlife subgroup losses for that year before being set off (under paragraph (m)(2)(ii) of this section) by a carryover of a nonlife subgroup loss to that year.

(v) *Setoff at bottom line.* The setoff of nonlife subgroup losses against consolidated partial LICTI does not affect life member deductions that depend in whole or in part on GO or TII. Thus, the setoff does not affect the amount of consolidated partial LICTI (as determined under paragraph (j)

of this section) for any taxable year but it merely constitutes an adjustment in arriving at the group's consolidated taxable income under paragraph (g) of this section.

(vi) *Ineligible nonlife member.* (A) The offsetable nonlife consolidated net operating loss that arises in any consolidated return year (that may be set off against consolidated partial LICTI in the current taxable year or in a succeeding taxable year) is the amount computed under paragraph (h)(2)(ii) of this section reduced by the ineligible NOL. For purposes of this subparagraph (3), the "ineligible NOL" is in the year the loss arose the amount of the separate net operating loss (determined under § 1.1502-21(b)) of any nonlife member that is ineligible in that year (and not the portion of the nonlife consolidated net operating loss attributable under § 1.1502-21(b) to such a member). (B) The carryovers of offsetable nonlife net operating losses under paragraph (m)(2)(ii) of this section do not include an ineligible NOL arising in a consolidated return year or a loss attributable to an ineligible member arising in a separate return year. See section 1503(c)(2). (C) For absorption within the nonlife subgroup of an ineligible NOL arising in a consolidated return year or a loss of an ineligible member arising in a separate return year which is not a separate return limitation year under paragraph (m)(3)(ix) of this section, see paragraph (m)(3)(vii) of this section.

(vii) *Absorption of ineligible NOL.* (A) If all or a portion of a nonlife member's ineligible NOL (determined under paragraph (m)(3)(vi)(A) of this section) may be carried back or carried over under paragraph (h)(2) of this section to a particular consolidated return year of the nonlife subgroup (absorption year), then notwithstanding § 1.1502-21A(b)(3)(ii) or 1.1502-21(b), the amount carried to the absorption year will be absorbed by that member's contribution (to the extent thereof) to nonlife consolidated taxable income for that year.

(B) For purposes of (A) of this subdivision (vii), a member's contribution to nonlife consolidated taxable income

for an absorption year is the amount of such income (computed without the portion of the nonlife consolidated net operating loss deduction attributable to taxable years subsequent to the year the loss arose), minus such consolidated taxable income recomputed by excluding both that member's items of income and deductions for the absorption year. The deductions of the member include the prior application of this paragraph (m)(3)(vii) to the absorption of the nonlife consolidated net operating loss deduction for losses arising in taxable years prior to the particular loss year.

(viii) *Election to relinquish carryback.* The offsetable nonlife consolidated net operating loss does not include the amount that could be carried back under paragraph (h)(2) of this section but for the common parent's election under section 172(b)(3)(C) to relinquish the carryback. See section 1503(c)(1).

(ix) *Separate return limitation year.* The offsetable nonlife consolidated net operating and capital loss carryovers do not include any losses attributable to a nonlife member that were sustained (A) in a separate return limitation year (determined without section 1504(b)(2)) of that member (or a predecessor), or (B) in a separate return year ending after December 31, 1980, in which an election was in effect under neither section 1504(c)(2) nor section 243(b)(2). For purposes of this paragraph (m), a separate return limitation year includes a taxable year ending before January 1, 1981. See section 1507(c)(2)(A) of the Tax Reform Act of 1976 and §§ 1.1502-15 and 1.1502-15A (including applicable exceptions thereto).

(x) *Percentage limitation.* The offsetable nonlife consolidated net operating losses that may be set off against consolidated partial LICTI in a particular year may not exceed a percentage limitation. This limitation is the applicable percentage in section 1503(c)(1) of the lesser of two amounts.

The first amount is the sum of the offsetable nonlife consolidated net operating losses under paragraph (m)(2) of this section that may serve in the particular year (determined without this limitation) as a setoff against consolidated partial LICTI. The second amount is consolidated partial LICTI (as defined in paragraph (j) of this section) in the particular year reduced by any nonlife consolidated net capital loss that sets off consolidated partial LICTI in that year.

(xi) *Further limitation.* Any offsetable nonlife consolidated net operating loss remaining after applying the percentage limitation that is carried over to a succeeding taxable year may not be set off against the consolidated partial LICTI attributable to a life member that was not an eligible life member in the year the loss arose. See section 1503(c)(2).

(xii) *Restoration rule.* The carryback of a consolidated LO or life consolidated net capital loss under paragraph (l) of this section that reduces consolidated partial LICTI (or life consolidated capital gain net income) for a prior year may reduce the amount of nonlife subgroup losses that would offset consolidated partial LICTI in that prior year. Thus, that amount may be carried over under paragraph (h)(2) or (4) of this section from that prior year in determining nonlife consolidated taxable income in a succeeding year or serve as offsetable nonlife subgroup losses in a succeeding year.

(4) *Acquired groups.* [Reserved]

(5) *Illustrations.* The following examples illustrate this paragraph (m).

* * *

(n) ***Nonlife consolidated taxable income set off by life subgroup losses*** — (1) *In general.* The life subgroup losses consist of the consolidated LO and the life consolidated net capital loss (as determined under paragraph (l)(4) of this section). Under paragraph (g)(1) of this section, nonlife

consolidated taxable income is set off by the amounts of these two consolidated losses specified in paragraph (n)(2) of this section.

(2) *Amount of setoff.* The portion of the consolidated LO or life consolidated net capital loss that may be set off against nonlife consolidated taxable income (determined under paragraph (h) of this section) is d termined by applying the rules prescribed in paragraph (m)(2) and (3) of this section in the following manner:

(i) Substitute the term "life" for "nonlife", and vice versa.

(ii) Substitute the term "nonlife consolidated taxable income" for "consolidated partial LICTI", and vice versa.

(iii) Substitute the term "consolidated LO" for "non-life consolidated net operating loss", "paragraph (l)" or "paragraph (j)" for "paragraph (h)", and "section 812(b)(3)" for "section 172(b)(3)(C)".

(iv) Paragraphs (m)(3)(vi), (vii), (x), and (xi) of this section do not apply to a consolidated LO.

(v) Capital losses may not be deducted more than once. See section 818(e) and also the requirements in section 818(f).

(vi) The setoff of life subgroup losses against nonlife consolidated taxable income does not affect nonlife member deductions that depend in whole or in part on taxable income.

(3) *Illustrations.* The following examples illustrate this paragraph (n).

* * *

(o) ***Alternative tax*** — (1) *In general.* For purposes of the alternative tax under paragraph (f)(7)(ii) of this section, consolidated net capital gain is the sum of the following two amounts:

(i) The nonlife consolidated net capital gain reduced by any setoff of a life consolidated net capital loss.

(ii) The life consolidated net capital gain reduced by any setoff of a nonlife consolidated net capital loss.

(2) *Net capital gain.* For purposes of this paragraph (o):

(i) Nonlife consolidated net capital gain is computed under §§ 1.1502-41A or 1.1502-22T (as appropriate) except that it may not exceed nonlife consolidated taxable income (computed under paragraph (h) of this section).

(ii) Life consolidated net capital gain is computed under §§ 1.1502-41A or 1.1502-22T (as appropriate), applied in a manner consistent with paragraph (l)(4) of this section, except that it may not exceed consolidated partial LICTI (as determined under paragraph (j) of this section).

(iii) *Setoffs.* Setoffs are determined under paragraphs (m) or (n) of this section (as the case may be).

(p) ***Transitional rule for credit carryovers.*** For limitations on credits arising in taxable years ending before January 1, 1981, that may be carried over to taxable years beginning on or after that date, section 1507(c)(2)(A) of the Tax Reform Act of 1976 and the principles in paragraph (h)(3) of this section (relating to limitations on loss carryovers) apply.

(q) ***Preemption.*** The rules in this section preempt any inconsistent rules in other sections (§§ 1.1502-1 through 1.1502-80) of the consolidated return regulations. For example, the rules in paragraph (m)(3)(vi) apply notwithstanding §§ 1.1502-21A(b)(3) and 1.1502-79A(a)(3) (or § 1.1502-21, as appropriate).

(r) ***Other consolidation principles.*** The fact that this section treats the life and nonlife members as separate groups in computing, respectively, consolidated partial LICTI (or LO) and nonlife consolidated taxable income (or loss) does not

affect the usual rules in §§ 1.1502-0 — 1.1502-80 unless this section provides otherwise. Thus, the usual rules in § 1.1502-13 (relating to intercompany transactions) apply to both the life and nonlife members by treating them as members of one affiliated group.

(s) ***Filing requirements***. Nonlife consolidated taxable income or loss under paragraph (h) of this section shall be determined on a separate Form 1120 or 1120 M and consolidated partial LICTI under paragraph (j) of this section shall be determined on a separate Form 1120 L. The consolidated return shall be made on a separate Form 1120, 1120 M, or 1120 L by the common parent (if the group includes a life company), which shows the set-offs under paragraphs (g), (m), and (n) of this section and clearly indicates by notation on the face of the return that it is a life-nonlife consolidated return (if the group includes a life company). See also § 1.1502-75(j), relating to statements and schedules for subsidiaries.